

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

SBC COMMUNICATIONS INC.,
SBC DELAWARE INC.
AMERITECH CORPORATION,
ILLINOIS BELL TELEPHONE COMPANY
d/b/a AMERITECH ILLINOIS, and
AMERITECH ILLINOIS METRO, INC.

Docket No. 98-0555

Joint Application for approval of the
reorganization of Illinois Bell Telephone
Company d/b/a Ameritech Illinois, and the
reorganization of Ameritech Illinois Metro, Inc.
in accordance with Section 7-204 of
The Public Utilities Act and for all other
appropriate relief.

DRAFT PROPOSED ORDER ON REOPENING

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SAVINGS - SECTION 7-204(C)

Positions of the Parties

The Joint Applicants assert that Section 7-204(c) of the Public Utilities Act was not meant to apply to utilities such as Ameritech Illinois. In the alternative, the Joint Applicants maintain that any savings subject to such allocation should not exceed a three-year period and should flow through to ratepayers via Ameritech Illinois' annual rate filing under the alternative regulation order. Finally, the Joint Applicants assert that savings applicable to Illinois jurisdictional, noncompetitive services will not exceed \$31 million dollars.

The Commission Staff argues that Section 7-204(c) does indeed apply to this proposed transaction. The Staff further asserts that the three-year time period proposed by the Joint Applicants will not permit the allocation of the full amount of savings to which ratepayers are entitled. The Staff recommends that merger costs and savings be calculated on an actual, as opposed to estimated basis. The Staff and the Joint Applicants agree that the annual price cap filings under the alternative regulation order provide the appropriate vehicle for flowing merger savings to ratepayers.

The Attorney General, the Cook County State's Attorney's Office and the Citizens Utility Board assert that Section 7-204(c) applies by its terms to this transaction and that merger savings should be allocated to ratepayers upon closing of the proposed transaction, should this Commission approve this transaction. Further, these parties maintain that an allocation of savings to ratepayers should be based upon the arms-length valuation of the transaction by the merging parties themselves. This "present value" allocation methodology results in a one-time permanent rate reduction of approximately \$472 million, to be passed on to ratepayers over a ten year period. In the alternative, the Government and Consumer parties propose that the Commission exercise its discretion and allocate 50% of the \$472 million

present value amount to noncompetitive ratepayers. These parties believe that such an apportionment would be the minimum fair and reasonable allocation. The Government and Consumer parties believe that the abbreviated proceedings established for the annual price cap filing under alternative regulation are not the appropriate forum in which to undertake the complex process of accounting for merger savings.

The Neighborhood Learning Networks (NLN) agrees that Section 7-204(c) applies to this proceeding. NLN posits that savings allocable to ratepayers total approximately \$100 million per year, for a ten year period. Of this sum, NLN believes that \$25 million per year should be allocated to disadvantaged and underserved populations in the form of local investment in computer equipment, facilities and on-line information services which serve to “bridge the digital divide” between persons with ready access to such facilities.

Commission Conclusion and Analysis

The record demonstrates that the Joint Applicants have not adequately responded to the Commission’s concerns expressed in Question 8 relating to the calculation of merger-related savings and costs by Joint Applicants. The Commission requested “a total and complete breakdown detailing the Joint Applicants’ estimate of cost-savings associated with this merger,” and then proceeded to itemize the specific points of clarification it required with respect to the calculation of merger savings and costs, and the apportionment of those savings and costs among SBC, various Ameritech Corporation affiliates, and Ameritech Illinois.¹

¹ See Question (8) in Attachment A to Chairman Richard Mathias’ letter of June 4, 1999 to Hearing Examiners Mark Goldstein and Eve Moran.

The Commission posed this question because the Joint Applicants' prior testimony was lacking in sufficient detail on the method Joint Applicants used for calculating and assigning savings and costs to the various post-merger entities. In this proceeding on reopening, the Joint Applicants made little or no effort to provide new information regarding the breakdown of savings; rather Joint Applicants incorporated information previously of record into a chart. Staff witness Marshall confirmed this assessment when she testified that "no additional data regarding savings" had been provided in response to the Commission's request.

Accordingly, we find that the Joint Applicants have failed to present adequate evidence regarding the measure of merger savings in this matter. We therefore reject Joint Applicants position regarding the measure of savings and the allocation of savings to ratepayers herein.

The Staff's position has merit in that it calls for ratepayers to benefit directly from the synergies associated with this proposed transaction. However, the Staff's proposal that savings be calculated subsequent to the transaction and in the context of Ameritech Illinois' annual rate filings associated with the alternative regulation plan is flawed. Joint Applicants' witness Kahan admitted under cross-examination that the determination of merger-related savings would be virtually impossible three years following consummation of the merger. We find, therefore, that allocation of savings in the manner recommended by the Staff is not feasible and would result in an inadequate allocation of savings to ratepayers. Accordingly, we must reject it.

The Neighborhood Learning Network bases its savings estimate upon a \$1.4 billion figure provided by the Joint Applicants. We cannot accept this figure nor do we find NLN's calculation of allocable savings to have the precision and the exactitude that we require. While

we share the Neighborhood Learning Network's concerns regarding inequitable access to the telecommunications network and associated computer and information services, we cannot adopt NLN's method of allocation.

In contrast, the savings methodology proposed by the Government and Consumer Intervenor is supported by evidence of record. Further, GCI's approach of allocating savings at the consummation of the proposed transaction has the distinct advantage of conserving the Commission's resources by not requiring that this matter be revisited with each annual rate filing. In addition, we conclude that it will be difficult if not impossible to determine the measure of savings over time after the consummation of the transaction. Thus, we find that allocation of savings at consummation of the transaction rather than through the annual rate filing is the more equitable, economical and realistic approach and we adopt it.

We do not accept the Joint Applicants' estimate of allocable savings in this matter, and the Staff's method presents insuperable administrative problems, as well as practical accounting challenges described above. In contrast, the GCI method of allocating savings based upon evidence of the savings and synergies the Joint Applicants expect to realize from the transaction, has the advantage of premising the savings allocation upon the actual value of the transaction as determined by the commercially sophisticated parties.

In conclusion, we find that Section 7-204(c) of the Public Utilities Act applies to the transaction before us. We further find that merger savings should be allocated at the consummation of the proposed reorganization. Finally, we determine that the sum allocable to ratepayers is \$471,584,762.00, as a one time rate decrease to be applied to all noncompetitive Ameritech Illinois services in accordance with the distribution method advanced by the Staff,

and to remain in effect for a ten year period.

[Alternative language to reflect 50% allocation]

Finally, we determine that the sum allocable to ratepayers is \$235,792,381.00, as a one time rate decrease to be applied to all noncompetitive Ameritech Illinois services in accordance with the distribution method advanced by the Staff, and to remain in effect for a ten year period.

ENFORCEMENT

Positions of the Parties

The Commission's June 4th letter to the Hearing Examiners included a broad request for information from the Joint Applicants regarding enforcement of merger-related conditions:

11. Reasonable and effective enforcement mechanisms for any condition imposed, including appropriate penalties, economic or otherwise;

The Joint Applicants responded with a series of enforcement commitments, including the appointment of a corporate officer to oversee implementation of, and compliance with merger commitments, to be overseen by an audit committee of SBC/Ameritech's Board of Directors. Within 6 months following the merger closing, and annually thereafter, Joint Applicants offer to file with the Commission a report detailing its compliance with its merger commitments. Additionally, Joint Applicants have proposed to hire, at their own expense, independent auditors to verify SBC/Ameritech's compliance through compliance reviews, to be issued 1 year after the merger closing and for three years after the merger closing. Both the compliance report and the auditors' review would be filed with the Commission for the public

record.

Direct testimony filed by SBC witness Kahan on reopening stated that the compliance officer, by reporting directly to the audit committee of SBC/Ameritech's Board of Directors, will have "the ability to impact corporate policies, actions and spending in a direct and immediate manner." Kahan offered that the existence of a single compliance officer with such authority would facilitate the Commission's ability to seek and receive responses on all issues regarding the Joint Applicants compliance with Commission obligations.

In its June 15th letter to the Hearing Examiners, (Attachment A-1, Item 12) the Commission sought to clarify its first request for evidence on compliance verification and the enforcement of conditions, as contained in Item No. 11 of the June 4th letter:

- 6) For any and all proposed commitments made by the Applicants throughout their June 10, 1999 filing, what are the specific enforcement mechanisms which would be used by the Commission in the event of non-compliance with such commitments?

The Joint Applicants responded:

Joint Applicants have attempted to address the specific enforcement mechanisms appropriate to specific commitments throughout their testimony. In addition to the stated mechanisms, the Commission retains full authority over Joint Applicants to investigate and/or conduct hearings on any complaints about non-compliance. In addition to its statutory enforcement mechanisms, the Post Exceptions Proposed Order identified an additional penalty/incentive mechanism to ensure Joint Applicants full compliance with the commitments they have made in this docket, i.e., an increase in the savings allocation flowed through to Illinois ratepayers.

SBC witness Kahan's supplemental direct testimony on reopening, filed in support of the above answer, added nothing more specific, but repeated the identical language that appeared in the Joint Applicants' answer.

Lee L. Selwyn, testifying on behalf of Government and Consumer Intervenors, offered direct testimony on reopening in response to the answer and testimony submitted by the Joint Applicants. Dr. Selwyn opined that both SBC and Ameritech have poor track records in abiding by commitments made to regulatory agencies in exchange for some desired relief. Selwyn explained that recent commitments made by SBC in Connecticut and Ameritech in Indiana to the respective public utility commissions in those states had either not been fulfilled or were the subject of attempted modifications soon after the utility made them. Specifically, record evidence presented by Selwyn included a recently filed request made by SBC to the Connecticut Department of Public Utility Control, asking that they be permitted to modify their statewide cable franchise obligation, an SBC commitment originally made to the DPUC when SBC acquired Southern New England Telephone Corporation. Through the Application, SBC 's cable affiliate seeks to reduce its facility deployment from the statewide commitment they originally made (169 towns) to only the 26 towns it currently serves or will soon serve in the near future, while it studies "alternative technologies." *Evaluation and Application to Modify Franchise Agreement by SBC Communications, Inc., Southern New England Telecommunications Corporation, and SNET Personal Vision, Inc.*, filed April 1, 1999, Docket No. 99-04-xx. Under cross-examination, SBC witness Kahan responded that SBC's filing, which requests modification of Section 3 of its cable affiliate's franchise agreement, was not actually a request for modification.

According to Selwyn, Ameritech, too, has fallen short of recent regulatory commitments. Comments filed by the Indiana Utility Regulatory Commission with the Federal Communications Commission and introduced by GCI into the instant record, reported that

Ameritech Indiana had fallen far short of a 6-year commitment -- made in connection with its alternative regulatory plan -- to spend \$20 million annually to connect schools, hospitals and government centers to a two-way learning network. The IURC's review of Ameritech Indiana's expenditures revealed that the company was delinquent in its commitment and that Ameritech had included investments in retail stores, an amusement park, an industrial plant and a hotel in its accounting of expenditures that were meant for public institutions.

Commission Analysis and Conclusion

The Commission has reviewed the responses filed by Joint Applicants with respect to the enforcement of the Joint Applicants' voluntary commitments, as well as the testimony filed in support of those answers. It first must be noted that the Commission's question addressed enforcement mechanisms "for any condition imposed." The Joint Applicants' response, however, refers to "these commitments," not to any conditions. The Commission requires the Applicants to adhere to all conditions, either voluntary or imposed by the Commission.

Given the Indiana Public Utility Regulatory Commission's recent experience with Ameritech Indiana's network infrastructure accounting, we believe that every effort should be made before the merger is approved to insure that the Commission and interested parties can obtain a complete and comprehensive accounting of Joint Applicants' compliance with every condition contained in this Commission's orders. In order to eliminate any ambiguity in this regard, we conclude that Joint Applicants shall file compliance reports with respect to all conditions imposed by the Commission. The independent auditors, likewise, shall address, all conditions that are part of the Commission's approval of this merger.

The filing of both of these reports with the Commission shall be public filings, with both made available on the Joint Applicants Internet site. The material contained within these reports shall not be presumed proprietary or confidential. Proprietary and/or confidential treatment may be sought only through a formal request to the Commission, to be filed 30 days prior to the filing of either report. Commission Staff and interested parties shall then be provided with an opportunity to respond to the request for proprietary treatment. In any request for proprietary/confidential treatment of any such material, the burden shall be on the party proposing proprietary and/or confidential treatment. Opportunity to comment on each report, including the opportunity to present evidence, will be afforded to ICC Staff and interested parties. The Commission will initiate official proceedings to formalize the results of the independent audit, issue findings on the audit results, and assign any penalties due to non-compliance.

J. Conditions To the Approval of the Proposed Reorganization.²

(19) Joint applicants will be held responsible for ~~recording~~ distribution consistent with this order of all savings and all costs relating to the merger in the manner described herein with the ultimate result that ~~25% a~~ \$471,584,762.00 million dollar rate decrease to remain in place for ten years of the actual net merger savings realized in the three years following this Commission's approval or until this issue is resolved in the context of the Alternative Regulation Plan, whichever is sooner, be the allocation to ratepayers as previously set forth in this Order.

[alternative language to reflect 50% savings allocation]

²Based on Condition 19 in PEPO

(19) Joint applicants will be held responsible for ~~receding~~ distribution consistent with this order of all savings and all costs relating to the merger in the manner described herein with the ultimate result that ~~25% a \$235, 792,381 million dollar rate decrease to remain in place for ten years of the actual net merger savings realized in the three years following this Commission's approval or until this issue is resolved in the context of the Alternative Regulation Plan, whichever is sooner,~~ be the allocation to ratepayers as previously set forth in this Order.

This amount will be referred to as the floor. To the extent, however, that the Commission finds that the Company has failed to meet one or more conditions of this order, the Commission may, after considering the significance of the condition to ratepayers and the degree of non-compliance, increase the allocation of merger savings from the baseline up to ~~an amount not exceeding 50% of the actual~~ 100% of the estimated net merger savings. This amount will be referred to as the cap. This mechanism is perceived to be the best and most effective way to protect the interests of the utility and its customers by ensuring a continuing quality of service and the enhancement of services which will be achieved through compliance with our conditions. This mechanism is not to be construed as either a penalty or an incentive.

III. Findings and Ordering Paragraphs

(8) the provisions of Section 7-204(c) are being applied to the reorganization, so that ~~25%~~ 100% of the net merger-related savings allocable to Illinois will be allocated to the merged company's customers and in the manner previously outlined; ~~if however, compliance with one or more of the conditions of our Order is not demonstrated in the interim proceeding, the allocations of net savings to customers will be increased to no more than 50%.~~

[alternative language reflecting a 50% allocation]

(8) the provisions of Section 7-204(c) are being applied to the reorganization, so that ~~25%~~ 50% of the net merger-related savings allocable to Illinois will be allocated to the merged company's customers and in the manner previously outlined; ~~if however, compliance with one or more of the conditions of our Order is not demonstrated in the interim proceeding, the allocations of net savings to customers will be increased to no more than 50%.~~

In addition, the following language should be added to the findings and ordering paragraphs to reflect the Government and Consumer Intervenor's recommendations on compliance enforcement:

Joint Applicants are ordered to make public filing of SBC-Ameritech's compliance report and the independent auditors' review, with both filings made available on the Joint Applicants' Internet sites. Proprietary and/or confidential treatment shall not be presumed for either report, but must be obtained through formal filings with the Commission, to be made 30 days prior to the official filing of the reports with the Commission. The burden of proof with respect to the proprietary or confidential treatment of such documents shall rest with the party propounding such treatment. Interested parties, including Staff, will have an opportunity to respond to both reports, and may present evidence to the Commission to support their positions. The Commission will initiate official proceedings to formalize the results of the independent audit, issue findings on the audit results, and assign any penalties due to non-compliance.